ST 04-0106-GIL 07/07/2004 COMPUTER SOFTWARE

If transactions for the Licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software nor the subsequent software updates will be subject to Retailers' Occupation Tax. See 86 Ill. Adm. Code 130.1935. (This is a GIL).

July 7, 2004

Dear Xxxxx:

This letter is in response to your letter dated December 12, 2003, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. *Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110.* The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

> Please provide a Private Letter Ruling regarding the tax status of our company's software support agreements, a copy of which has been included with this letter.
>
> In summary, the company licenses computer software programs to its customers. The software is generally customized to fit each customer's different needs; the fees for the customizations vary greatly. In conjunction with the license agreement, each customer is asked to sign a separate support agreement for the provision of technical support services which are then invoiced on an annual basis and pre-paid by the customer for each twelve month period. As part of the technical support, the company provides telephone support and distributes upgrades in electronic format, via the internet or CD. Does the value of the underlying software (some of which can be classified as 'canned' as it forms the basis for all customers' software and some of which is customized and may represent more than 50% of the total license fee) impact the determination as to whether the support agreement should be taxed? The support agreement provides for technical support to the software package. Additional services in connection with upgrades that may be provided by the company as a result of the customizations would be billed in addition to the base annual technical support fee. Given the foregoing facts, should the company's support agreement be subject to tax in Illinois?

Thank you for your assessment of this matter.

DEPARTMENT'S RESPONSE:

The Department cannot give you a binding ruling as to whether the agreement attached to your letter is subject to tax without specific information as to the level of customization of the software that is subject to the support agreement.

Generally, sales of "canned" computer software are taxable retail sales in Illinois. Sales of canned software are taxable regardless of the means of delivery. For instance, the transfer or sale of canned computer software downloaded electronically would be taxable.

However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See subsection (c) of 86 Ill. Adm. Code 130.1935. Custom computer programs or software must be prepared to the special order of the customer.

If transactions for the licensing of computer software meet all of the criteria provided in subsection (a)(1) of Section 130.1935, neither the transfer of the software nor the subsequent software updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

A) It is evidenced by a written agreement signed by the licensor and the customer;

B) It restricts the customer's duplication and use of the software;

C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;

D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and

E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under subsection (c) of Section 130.1935, they may not be taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the entire agreements would be taxable as sales of canned software.

I hope this information is helpful. If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Edwin E. Boggess
Associate Counsel

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